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Supreme Court, U. S.
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MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No.

ANTHONY B. CATALDO and ADA W. CATALDO,

Petitioners,

against

UNITED STATES OF AMERICA,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Official Report Below

There is no official report of the case below. The decisions of the District Court and of the Court of Appeals in the second circuit are appended hereto.

Jurisdictional Statement

The Court of Appeals for the second circuit entered its decision of affirmance made from the bench on January 24, 1972 and a judgment was entered that day in accordance with Rule 36 of the Federal Rules of appellate procedure. On March 6, 1972 the United States Court of Appeals for the Second Circuit entered its decisions on the petition for rehearing and petitioners' suggestion for an en banc hearing, denying the same.

This court has jurisdiction pursuant to 28 U.S.C.A. section 1254 (1) which reads as follows:

Sec. 1254, Court of Appeals; Certiorari; Appeal; Certified Questions:—Cases in the Court of Appeals may be reviewed by the Supreme Court by the following methods: (1) by writ of certiorari granted upon the petition of any party, to any civil or criminal case, before or after rendition of judgment or decree.

Questions Involved

1. Does *Flora* v. *United States*, 357 U.S. 73, affirmed on rehearing, 362 U.S. 145, bar an inquiry into the facts of whether an income tax assessment was a fraudulent and capricious one and hence it was not an assessment for all purposes including the jurisdictional sections 28 U.S.C.A. 1340; 28 U.S.C.A. 1346(a)(1) and 26 U.S.C.A. 7422.

2. If such an inquiry were to show that there are facts to support the conclusion that the assesment was a fraudulent and capricious one, would the courts below have jurisdiction to direct the refund of monies paid or withheld on account of such an assessment even though the amounts paid or withheld may be less than the amount of such fraudulent assessment.

Constitutional provisions, treaties, statutes, ordinances or regulations involved

The Internal Revenue Code of 1954 as amended as reflected in the following Sections.

Section 2 of 26 U.S.C.A. which reads in pertinent part as follows:

"Sec. 2. Tax in case of joint return or return of surviving spouse.

(a) Rate of tax.—In the case of a joint return of a husband and wife under section 6013, the tax imposed by section 1 shall be twice the tax which would be imposed if the taxable income were cut in half. * * *."

Section 61 of 26 U.S.C.A. in its pertinent parts reads as follows:

"Sec. 61. Gross income defined.

(a) General definition.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items: * * *."

Section 63 of 26 U.S.C.A. reads in its pertinent parts as follows:

"Section 63. Taxable income defined

(a) General rule.—Except as provided in subsection (b), for purposes of this subtitle the term 'taxable income' means gross income, minus the deductions allowed by this chapter, other than the standard deductions allowed by part IV (sec. 141 and following). * * *."

Section 161, 26 U.S.C.A. which reads as follows:

"Section 161. Allowance of deductions

In computing taxable income under section 63(a), there shall be allowed as deductions the items specified in this part, subject to the exceptions provided in part IX * * *."

Section 162 in its pertinent provisions reads as follows:

"Section 162. Trade or business expenses

(a) In general.—There shall be allowed as a deduction all the necessary expenses paid or incurred dur-

ing the taxable year in carrying on any trade or business, including * * *."

Section 212 of 26 U.S.C.A. in its pertinent provisions reads as follows:

"Section 212. Expenses for production of income

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income, * * *"

Section 7422 of 26 U.S.C.A. reads in its pertinent provisions as follows:

"Section 7422. Civil actions for refund.

(a) No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected or any penalty claimed to have been collected without authority, or if any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the secretaary or his delegate, according to the provisions of law in that regard and the regulations of the Secretary or his delegate established in pursuance thereof.

* * *

(d) Credit treated as payment.—The credit of an overpayment of any tax in satisfaction of any tax liability shall, for the purpose of any suit for refund of such tax liability, so satisfied, be deemed to be a payment in respect of such tax liability at the time such credit is allowed."

28 U.S.C.A. 1340, which reads as follows:

"Sec. 1340, Internal Revenue, customs duties.

The district courts shall have original jurisdiction of any civil action arising under any act of Congress providing for internal revenue, or revenue from imports or tonnage except matters within the jurisdiction of the customs court."

28 U.S.C.A. 1346 (a) (1) reads as follows:

"Section 1346, United States as Defendant.

(a) The district courts shall have original jurisdiction, concurrent with the court of claims, of:

(1) Any civil action against the United States for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal revenue laws."

Statement of the Case

The assessment in this case is based upon a letter of deficiency dated March 14, 1969, which was made by an auditor of the field audit division, and affording the taxpayer no opportunity to appeal to the Appellate Division of the Internal Revenue Service. The letter covered two years, viz.: 1964 and 1965.

This suit deals only with the 1964 income tax return. The 1966 is in litigation, begun in the tax court. The taxpayers are husband and wife. The wife has no separate income. The husband is a lawyer actively practicing his profession. According to the letter of deficiency the assessment was made because of a certain sum of alleged

unreported income and a small disallowance of claimed business expense. However, the alleged sums of unreported income were either not received in 1964 or were gross receipts and not gross income. A total unreported income of $24,758.24 was alleged by said letter. Of the said total of $24,758.24 allegedly unreported income, the sum of $16,429.49 was received in 1963, and was the proceeds of a settlement of a suit received for a client. After paying certain liabilities of the client, the balance was retained. The balance retained had been duly reported as income by the taxpayer. Yet the whole settlement fund was claimed to be unreported income for 1964 although the fund was received in 1963. Another sum, one for $660 was not reecived in 1964, but in 1966. It was a fund entrusted to the lawyer taxpayer to pay another client's rent of an apartment in New York City and it was used for that purpose, on due date, viz.: June 1, 1966. The balance of the $24,758.24 was a composite of certain sums of monies received by the lawyer taxpayer from or for the account of clients or others and which were used for the purposes received. The auditor was shown proof of the gross receipt character of the funds and of the fulfillment of the purposes, but the proof was disregarded and ignored. He was also shown the date of the receipt of the $16,429.49 as being in November 1963 by proof of the deposit in taxpayer's account that date. He was shown the proof of the deposit of $660 in May 1966 and the payment of that sum on June 1, 1966 for the purposes intended, but he disregarded that proof also.

He was shown the proof of payment of the remainder of the gross receipts and that was ignored. He was shown that business expenses were paid by check and that the character of the expense was obviously of a business nature, such as dues to bar associations and other professional associations to which the lawyer taxpayer belonged, but they were disallowed. Disallowed also were the whole of all club dues and expenses at clubs for entertainment.

The auditor had even disallowed contributions paid to recognized charities made by check which had been paid and charged to the taxpayer's account. The cancelled checks were exhibited to the auditor.

The auditor acted without regard to the facts and in spite of the proof of them. He drew inferences upon assumptions that had no foundation in fact. When he had found no record of the $16,429.49 in the 1964 books he was examining, he asked the taxpayer whether he hadn't received that sum. This showed that this auditor had come prepared to inquire about that sum specifically. The taxpayer complied with the request and showed the auditor the 1963 records and he showed where that sum was noted as received in that year. The auditor had even shown some familiarity with the name of G.O. General Contracting Corp. who was the client and for whose account that sum had been received.

It so happened that sometime before that date the taxpayer had won priority over the government in a suit involving a sum of $8,570.51, an amount held by the taxpayer and another lawyer in trust for G.O. General Contracting Corp. The government was asserting a tax lien against the fund arising out of the tax liabilities of G.O. General Contracting Corp. and the taxpayer was asserting attorney's liens against the same fund. After plaintiff had won priority as a lienor for his fees in that suit, the auditor appeared to make an audit of taxpayer's books.

The deficiency letter in question was the result of the audit made. Plainly, the auditor was seeking to find tax where none was due. The taxpayers had regularly and duly filed their return for 1964 and paid the tax of $709.15 that was returned.

Upon receipt of the assessment, they paid the sum of $200 under protest and duly filed simultaneously with the payment, a claim for refund alleging no additional tax was due and demanded the return of the $200. No action was

taken on this claim. This suit was started January 12, 1971. Thereafter, refunds of other taxes fell due to the taxpayers, but such sums were credited against the assessment in suit viz.: On April 15, 1970, $1,138.04; on April 15, 1971, $345.80; and on April 15, 1972, $305.70; making a total of $1,989.54. This is the sum now wrongfully withheld from the taxpayers by the government.

The District Court's Jurisdiction

There is jurisdiction in the district over this suit because of Sections 1340 and 1346(a)(1) of 28 U.S.C.A. Also as the Federal Internal Revenue Act is involved this suit is deemed to be founded upon a "Law of Congress" within the meaning of the jurisdictional statute. *United States* v. *Hovslef*, 237 U.S. 1.

ARGUMENT

Was the assessment involved an assessment as spoken of in the jurdisdictional statutes.

There is no dispute about an assessment which has been made in the regular course of the auditor's duties where he has made a bona fide attempt at ascertaining the facts and he has applied the law to them. If he has made a mistake of fact or mistake of law, then the remedy is stated in *Flora* v. *United States*, viz; pay first and litigate later. But what of the case where the auditor deliberately disregarded the facts, manufactured facts to support the desired legal conclusion of finding a tax even though none was due. He even issued a notice of deficiency instead of a 30 day letter. He evidenced his purpose of "looking" for tax as though forewarned of some event and finding that the event was not one which could produce a tax, he nevertheless regarded it as a taxable item despite the facts. As difficult as it may be to define a fraudulent

action, where, as here, we have an intent by an auditor to use the law and his official position to abstract unlawfully, monies from the taxpayer, would not these facts be the very elements of an actual fraud. Could an assessment based upon the fraudulent audit of such an auditor be an assessment which is void ab initio or would it be only one that would be voidable? If either, is such an assessment within the scope of Section 1346(a)(1) of 28 U.S.C.A. which speaks of taxes "erroneously or illegally assessed or collected" for the maintenance of a suit for refund? Would such an assessment be within the limitation upon Section 1346(a)(1) placed upon it by *Flora* v. *United States*, 357 U.S. 73, 362 U.S. 145, to the effect that there is no jurisdiction of a refund suit until the whole assessment has been made? In *Flora* v. *United States*, the assessment was one issued in the regular course of the duties of the auditors of the tax department. The dispute was a difference of views of the law which had to be resolved by the court. Here the difference is not over the errors, but over the fraud of being subjected to an assessment for an amount that is not due. Chief Justice Warren in *Enochs* v. *Williams*, 370 U.S. 1 at p. 7 said "In such a situation the exaction is merely 'in the guise of tax'." This idea had also been expressed in *Miller* v. *Standard Nut Margerine Co.*, 284 U.S. 498.

In considering a case commenced in the tax court, where the assessment was attacked as arbitrary and excessive, this court said in *Helvering* v. *Taylor*, 293 U.S. 507 at page 515 "But where as in this case the taxpayer's evidence shows the commissioner's determination to be arbitrary and excessive, it may not reasonably be held that he is bound to pay a tax that confessedly he does not owe * * *". This *Taylor* case recites a rule of evidence which operates to relieve the taxpayer of the burden of a presumption of correctness normally operating in favor of an assessment. Where the taxpayer can show a capricious assessment, the presumption is lost and the commissioner

is required to prove the correctness of his claim. See Mehrtens, Law of Federal Income Taxation, Section 50.71 at p. 196. Also see *Cullers* v. *Comm'r.*, 237 F.(2) 611, 614, *Cohen* v. *Comm'r.*, 266 F.(2) 5, 11; *Welch* v. *Comm'r.*, 297 F.(2) 309; *Weir* v. *Comm'r.*, 283 F.(2) 675; *Barnes* v. *Comm'r.*, 408 F.(2) 65, 70. This court has not again considered the question since *Helvering* v. *Taylor.*

The courts below refusing to consider an affidavit of facts from the plaintiffs to prove the fraudulent character of the execution of his duties by the auditor to arrive at his report which induced the assessment, and restricting themselves to the face of the complaint and finding that the amount to be refunded was less than the amount of the assessment, and placing themselves under the rule of *Flora* v. *United States*, granted the motion of the defendant to dismiss the complaint for an alleged lack of subject matter jurisdiction.

The district court expressed itself in its order of dismissal. The Court of Appeals informally stated from the bench during argument that it was bound by *Flora* v. *United States* and that only this court would have the power to make an exception in the case of a fraudulent assessment.

In view of the strong language of Chief Justice Warren in *Flora* v. *United States*, there appears to be no will on the part of the courts below to recognize the difference between an assessment which originates in a bona fide exercise of the taxing authority, and one which originates in the dishonest endeavor of an official to exact money from a taxpayer in the guise of a tax. This inquiry, if made at the threshold of a case on a motion addressed to the complaint before joining issue, will not create the objectionable practice of litigating without payment except in the case where the court has preliminarily decided that a bona fide issue of a fraudulent assessment is raised. If such a preliminary issue is decided wouldn't it be un-

just to collect the tax. If it is isn't raised, the complaint could be dismissed. Nor would the principle of *Flora* v. *United States* of pay first litigate later be violated in such a preliminary inquiry. The facts properly explored would immediately show not what was assessed but what was due as in the cases where the United States sue. See *Clinkenbeard* v. *United States*, 21 Wall. 65; *United States* v. *Rindskopf*, 105 U.S. 418; and *United States* v. *Philadelphia & Reading R.R. Co.*, 123 U.S. 113.

Although it would be error for the courts below to refuse to consider facts in support of subject matter jurisdiction (See *Bell* v. *Hood*, 327 U.S. 678; *Land* v. *Dollar*, 333 U.S. 731-735; and *Skelly Oil* v. *Phillips Pet. Co.*, 339 U.S. 667, 672), where the jurisdictional statute has been interpreted as it was in *Flora* v. *United States*, such statute is said to be limited to cases where the assessment has been paid in full. Consequently, there would be no necessity to examine into the facts of a dishonest assessment. But that is not what *Flora* really says. All it could say and what it did say is that in cases like the one before the court, the pay first, litigate later rule applied. The use of broad and sweeping language to the effect to be given to the jurisdictional statute in the future in cases which differ on the facts, would itself be endeavoring to legislate and as such, it could not be used to control decisions in future cases where the facts differ from *Flora* v. *United States*. Then, the jurisdictional statute must be re-read. Then it is respectfully submitted that the dissenting opinion of Mr. Justice Whittaker will become more forceful and alive to the situation presented by the facts of this case. After all, facts are the means of establishing the wrong, this court said in *Baltimore* v. *Phillips*, 274 U.S. 316. In view of that dissent of Mr. Justice Whittaker and of the comparison of the facts in this case with the words expressing the jurisdictional statutes, 28 U.S.C.A. 1340 and 1346 (a)(1), it is apparent that the district court would have jurisdiction of the subject mat-

ter of this case, but for the fear of the lower courts of disobeying the broad mandate of the pay first and litigate later principle of *Flora* v. *United States*. This catchy phrase such as pay first, litigate later seems to pervade over any suit touching upon assessments and refunds of monies paid in spite of the fact that the principle was applied within the framework of a certain specific set of facts. Where the facts differ, so much so that it would be unjust to require one unable to meet the demands of paying the whole assessment before he may be heard to complain about the dishonesty of the auditor, mischief will be done. As he cannot pay he cannot be heard.

Can plaintiffs pay this assessment? Their affidavits stated that they were unable to pay this assessment. One need only to read the deficiency letter in this case which covers the years of 1964 and 1966 to see that the total taxable income of this lawyer taxpayer had hardly totalled $2,400 to realize that plaintiff could not pay except out of future income and then on a when fees are collected basis. To pay off $14,000 would take years. Is the law then unable to provide an answer? The case of *Sirian Lamp Co.* v. *Manning, Collector of Internal Revenue*, 123 F.(2) 776, may provide an answer. Sue the collector and invoke the common law remedy of money had and received, and provide jurisdiction because the matter would concern "an act of Congress". Perhaps that case, too, may be subject to the rule of *Flora* v. *United States*, although, Mr. Justice Whittaker in his dissent seemed to think not saying that the fact that the suit was against the collector made the difference. See his opinion on the re-hearing, at 362 U.S. 145.

At any rate, it is respectfully submitted the difference in the facts of this case materially distinguishes this case from the facts in *Flora* v. *United States*. There have been no causes such as presented by the facts of this one, considered by this court. At least, diligent search has not

turned up any cases of similar factual structure as this that has been considered by this court. What might be even more important is the necessity of opening the doors of a fresh approach to allow the facts of a worthy case to be aired and given judicial freedom from the claims fashioned by the several Courts of Appeals following *Flora* v. *United States* in applying the pay first litigate later rule rigorously by doing the mathematical comparison. It will not hurt the treasury. It will aid justice It will provide more confidence in our system of checks and balances. It will not condone chicanery committed in the name of the law and of the United States.

CONCLUSION

For the above and foregoing reasons, it is respectfully submitted that a writ of certiorari to the Court of Appeals, Second Circuit, be granted plaintiffs.

Respectfully submitted,

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Tel. No. 212-962-0965

Certificate.

I HEREBY CERTIFY that three copies of the above and foregoing petition have been served upon Hon. Whitney North Seymour, United States Attorney, 40 Centre Street, New York, New York 10007, and upon Hon. Erwin Griswold, Chief of Appeals, United States Attorney, Washington, D.C., by depositing same in the United States Mails, first class postage prepaid this 2nd day of June, 1972.

ANTHONY B. CATALDO

APPENDIX

Decision of Metzner, D.J.

MAY 4, 1971

Cataldo v. *United States, 71 Civ. 84*

Defendant moves to dismiss the complaint for lack of subject matter jurisdiction. Plaintiff has submitted an affidavit discussing the merits and background of the claim, but the court has not considered it in deciding the motion. This decision relates solely to the face of the complaint.

The complaint alleges that jurisdiction is predicated on 28 U.S.C. Sec. 1346(a)(1), which deals with actions to recover taxes "alleged to have been erroneously or illegally assessed. . . ." The complaint seeks recovery of $1,338.04 paid against an assessment of additional income tax for the year 1964 of $11,215.17 plus $504.76 penalty. The complaint then continues with allegations of the additions to income and disallowance of deductions which plaintiff claims were improperly made and which were the basis for the assessment by the Internal Revenue Service.

Flora v. *United States*, 357 U.S. 63 (1958) *aff'd on rehearing*, 362 U.S. 145 (1960), is directly in point. A taxpayer seeking to challenge the correctness of an assessment in a suit for a refund must first pay the full amount of the deficiency. This is known as the "pay first and litigate later" principle. *Flora* v. *United States*, *supra* at 75.

The *Flora* case also answers the contention of the unfair burden such procedure places on the poor taxpayer. At page 75 the Court said:

> "It is suggested that a part-payment remedy is necessary for the benefit of a taxpayer too poor to pay the full amount of the tax. Such an individual is free to litigate in the Tax Court without any advance

payment. Where the time to petition that court has expired, or where for some other reason a suit in the District Court seems more desirable, the requirement of full payment may in some instances work a hardship. But since any hardship would grow out of an opinion whose effect Congress in successive statutory revisions has made no attempt to alter, if any amelioration is required it is now a matter for Congress, not this Court."

Motion granted. So ordered.

Dated: New York, N.Y.
May 4, 1971

CHARLES M. METZNER
U.S.D.J.

Petition to Reargue and Suggestion For *In Banc* Hearing.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

ANTHONY B. CATALDO, and ADA W. CATALDO,

Plaintiffs-Appellants,

-v-

UNITED STATES OF AMERICA,

Defendant-Appellee.

TO THE HONORABLE, THE CHIEF JUDGE AND THE JUDGES OF THE UNITED STATES COURT OF APPEALS, SECOND CIRCUIT.

The Petition of Anthony B. Cataldo respectfully shows:

FIRST: That this is a petition pursuant to Rule 40 of the Federal Rules of Appellate Procedure seeking a re-hearing of the appeal in this matter, and it is respectfully suggested that such re-hearing if granted, be held in banc.

SECOND: Petitioner had duly appealed from an order of the United States District Court of the Southern District of New York made by Hon. Charles M. Metzner granting the motion of the defendant to dismiss the complaint for lack of subject matter jurisdiction. Said order was affirmed by order of this court dated January 24, 1972 by a decision delivered from the bench after oral argument. This suit is to recover about $1700. paid or withheld against an alleged income tax assessment of about $14,000. which was arbitrarily, unlawfully and fraudulently

made by the auditor checking the income tax return of the plaintiffs for 1964. The undersigned, one of the plaintiffs, is a lawyer.

The alleged assessment resulted from treating as income certain gross receipts received as trust funds by the lawyer, and by disallowing certain business expense deductions. In both cases, the auditor refused to acknowledge the proof of the facts of the matters, but arbitrarily added some $35,000. as income in that unlawful manner. His actions were so arbitrary that an inference of a fraudulently conceived audit could be drawn by a trier of the facts. No claim of a failure to report income was made. The alleged additional income was, in fact, not income as defined in Section 61, I.R.S. The following points were overlooked by the panel affirming the order appealed from.

(a) That the Supreme Court in Flora v. U.S.A. 357 U.S. 61, reaffirmed on reargument, 362 U.S. 145, in upholding the rule of "pay first, litigate later," acted upon the assumption, as was the situation in that case, that the assessment was a valid assessment; whereas the fact here is that the assessment was an invalid one, it having been attacked by the plaintiff as being arbitrary and fraudulent;

(b) In refusing to consider the evidentiary proof of whether the assessment was valid or invalid.

The suggestion for an in banc hearing is justified because every American may be subject to an oppressive, overbearing and overreaching tax assessor whose wrongful actions ought not be left uncontrolled by our courts.

Argument

For a determination of question (a) all that is necessary is to read the Supreme Court's opinions in Flora v. U.S. It is clear from these opinions that the question of valid-invalid assessments was not considered by the Supreme Court. It was assumed throughout that case that the assessment was a lawful one albeit wrong according to

the plaintiff. Such decision, then, cannot be controlling upon the question here where it is alleged that the assessment was the result of the auditor's arbitrary refusal to accept the lawful evidence proving that the items were not as he claimed to be viz; additional income.

Yet, this court refused to consider the merits of plaintiff's claim to an unlawful assessment and said from the bench that it must affirm because of Flora; that only the Supreme Court could change that rule. The assessment in that case was not being questioned by that taxpayer; the only question was whether he could pay something on account of the assessment and then sue in the District Court for the recovery of that partial payment. Also in Cheatham v. U.S., 92 U.S. 85, the bona fides of the assessment was not questioned. This case was heavily relied on by the Supreme Court in Flora. If we may consider that even the decisions of the Supreme Court are subject to the usual rule of construction that the decision must be limited to the facts of the case, then the validity of the assessment was not in question and the rule laid down by the Supreme Court is limited to cases where the assessment was a bona fide one even though the taxpayer disputed its correctness.

Surely, the difference between a valid and an invalid assessment in the sense of a non-fraudulent-fraudulent purpose in making the assessment in question, presents a sufficiently important distinction to require this court to distinguish between that case and this. If the rule of Flora were to be applied to this case we would have to say that the rule would then become pay first, even though the assessment is not an assessment in the eyes of the law, and litigate later. Unfortunately, for this plaintiff, Chief-Justice Warren's language writing for the majority in Flora is broad and sweeping and appears to be calculated to promote the general welfare of the public exchequer. The language is so strong and clear in that vein

that the courts have in more or less slavish fashion, followed the broad mandate even to this case where the courts have not even dared to look at the facts. They have said pay first, litigate later, never mind the facts.

Naturally, when the government's auditor in this case proceeded to make an allocation of monies to income by refusing to accept the obvious facts, such action is plainly arbitrary. Where he treated a fund of $16,429.49 that plaintiff had received for a client on account of a settlement of a case in 1963, as income of the plaintiff for 1964 the transaction has to be arbitrary. When it was shown to the auditor from the records and correspondence that that sum was used to pay some creditors of the client and the balance was retained because the client owed the attorney a considerably larger amount and the amount retained was reported as income in the year retained, yet all this proof is disregarded and the claim is made that the whole $16,429.49 is additional income despite the taxpayer's treatment of the funds, then the auditor was willfully and knowingly claiming that a tax was due when this was not actually so. This is some proof of a fraudulent intent to collect tax where no tax is due. Add to this, the complete disallowance of contributions, of sales taxes, of medical expenses and of all association and club dues and expenses and even treating a sum of money received in 1966 as income in 1964 and the proof should appeal to a fair trier of the facts that the assessment was completely fraudulent. Even a motive for assessing a tax when no tax was due was suggested by the taxpayer. See pp. 17-19 of the appendix. That the auditor had knowledge of the truth of the plaintiff's treatment of the same items at the time has to be obvious.

Furthermore, the arbitrary and fraudulent character of the alleged assessment in this case must be accepted as true on this motion because it is the rule that on a motion to dismiss a complaint the plaintiff's allegations are taken

as true. See the authorities quoted at page 18 of the appellant's brief.

Where the government designs to issue a fraudulent assessment, the rights and duties of the parties are put into an entirely different light than where the assessment was honestly made even though the assessor might be wrong in his decision. It hardly appears to be necessary to say that where an assessment is an arbitrary one made in disregard of the facts and of the applicable law, that this court is not powerless to appreciate the difference between that situation and Flora. Yet, this court did say that it was bound by Flora and did say that it was powerless to act and change Flora. This attitude is to abandon its own powers and jurisdiction and this abandonment is made upon a misreading of Flora. On the other hand, even Chief-Justice Warren, who wrote the opinions in Flora, indicated that he might have thought otherwise if he believed that the assessment was an exaction under the guise of an assessment. See Enochs v. Williams 370 U.S. 1 where at page 7, the Chief Justice said that when the government could not recover under the assessment made: "the central purpose of the Act is inapplicable" referring to the practical necessity of the pay first litigate later rule implied in the jurisdictional statute. "An exaction in the guise of tax" was a term used by Chief-Justice in the Enochs case and taken from Miller v. Standard Nut Margerine Co., 284 U.S. 497, 450. In the Enochs case the Supreme Court investigated the facts to determine the good faith of the assessor.

The point of the petitioner's defense is that the only assessment upon which the government relies is an invalid one. If it is an invalid one, then there is no assessment by which to measure the payments to see if they are more or less than what is actually due the government. Hence, as the court cannot say that the tax is greater than the payments it cannot apply Flora to this case. To put it another way, a new assessment will have to be found so

that the comparison between payments and the assessment can be made to determine whether the payments are more or less than the true claim to tax. However, to find a new assessment it will be necessary to hold a trial.

Balancing the necessity of upholding a governmental act against the claim that it is a fraudulent act, the scales should surely preponderate in favor of the citizen claiming fraud. It can be fairly said that the government itself will not countenance acts of fraud in its name. This is the import and meaning of the rule laid down by the many cases that say that assessments are ordinarily presumed to be correct but if it is shown by the taxpayer that it is an arbitrary and unlawful one, then the presumption is lost and the situation would be as though there is no assessment. See:

Helvering v. *Taylor,* 293 U.S. 507, 514, 515;
Cullers v. *Comm'r.,* 237 F.(2) 611, 614;
Cohen v. *Comm'r.,* 266 F.(2) 5, 11;
Welch v. *Comm'r.,* 287 F.(2) 309;
Weir v. *Comm'r.,* 267 F.(2) 675;
Herbert v. *Comm'r.,* 377 F.(2) 65, 69, 70;
BL Ranch Inc. v. *Phinney,* 426 F.(2) 995;
Barnes v. *Comm'r.,* 408 F.(2) 65, 70.

In Helvering v. Taylor, supra, the Supreme Court said:

"Unquestionably, the burden of proof is on the taxpayer to show that the Commissioner's determination is invalid, * * *. But whereas in this case the taxpayer's evidence shows the Commissioner's determination to be arbitrary and excessive, it may not be reasonably held that it is bound to pay a tax that conceivably it does not owe, * * *"

In Cullers v. Comm'r, supra, the court said that an arbitrary assessment is "no criteria for the tax due and it may not be so used."

Mehrtens, Law of Federal Income Taxation, Volume 9, Section 50.71 at page 196 says:

> "* * * once there is such contrary evidence, this presumption vanishes and the case is wide open, * * * and once the burden of going forward with the proof is met, it is as though the presumption had never existed."

If this is the law, then why should these plaintiffs be denied the protection of that rule? Why should they be obliged to undertake the expense and the risk of appealing to the Supreme Court to get recognition that this case represent a departure from Flora? Why isn't that risk placed upon the government? The government is the one asserting rights against the truth of the matter and in fraud of plaintiff's rights. Besides, there is a whole world of difference between the financial capability of the government and that of the plaintiff who by the return filed has shown a net income of $11,000. for the whole year of 1964. But even this is not the point. The point is why shouldn't this court take note of the differences between this case and Flora and grant plaintiffs the right to litigate the alleged claim to a refund of monies had and received and unlawfully retained.

As to point (b) plaintiff attempted to add to the complaint and its attachments, an affidavit of facts which offered proof of the true character of the various items alleged by the government to be additional income, but neither the court below, nor this court would consider such proof. These papers showed that the auditor had disregarded the proof submitted by the taxpayer in support of showing that trust funds were not taxable income and that the expenses disallowed were actually business related. In Angerosa v. White Co., 248 App. Div. 425, aff'd 275 N.Y. 524, the Appellate Division said at page 431, "protection is given to whomever is injured by falsehood and deception; fraud vitiates everything which it touches and

troys the very thing which it was devised to support. e law does not temporize with trickery or duplicity." o see the general discussion on what is fraud in Bou- r's Law Dictionary, Rawles Edition, p. 1306. Can it be ubted that the rule for federal courts is the same? Yet, no time in this litigation has the government contra- ted the application of this rule of protection for the frauded nor has it made an effort at establishing the lidity of its assessment. The courts have gone along th the broad sweep of the language in Flora and the vernment has been vindicated; but at great prejudice the rights of these plaintiffs.

WHEREFORE, it is respectfully prayed that this court ant petitioners an opportunity to place the two ques- ons mentioned above before this court, in banc, in the terest of substantial justice to them and their rights.

Certificate of Counsel.

I hereby certify that the foregoing petition was filed in ood faith and in the firm belief that there exists good rounds for a reconsideration of the decision of this court January 24, 1972. I further certify that no delay is tended by this petition, but that its sole aim is to move the interest of substantial justice toward realizing laintiffs' rights under the facts of this case.

Respectfully submitted,

ANTHONY B. CATALDO
Anthony B. Cataldo
Attorney for appellants

Decision on Motion for Rehearing in U. S. Court of Appeals.

71-1717

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Anthony B. Cataldo and Ada W. Cataldo,

Plaintiffs-Appellants,

v.

United States of America,

Defendant-Appellee.

A petition for a rehearing having been filed herein by counsel for the appellants,

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

s/ HENRY J. FRIENDLY
HENRY J. FRIENDLY, Chief Judge

s/ LEONARD P. MOORE
LEONARD P. MOORE, U.S.C.J.

s/ WALTER R. MANSFIELD
WALTER R. MANSFIELD, U.S.C.J.

March 6, 1972

Decision Denying Petition for *In Banc* Hearing.

71-1717

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Anthony B. Cataldo and Ada W. Cataldo,

Plaintiffs-Appellants,

v.

United States of America,

Defendant-Appellee.

A petition for a rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the appellants and no active circuit judge having requested that a vote be taken on said suggestion,

Upon consideration thereof, it is .

Ordered that said petition be and it hereby is denied.

HENRY J. FRIENDLY
Chief Judge

March 6, 1972